

Union Calendar No.

108TH CONGRESS
2D SESSION

H. R. 3574

[Report No. 108-]

To require the mandatory expensing of stock options granted to executive officers, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 21, 2003

Mr. BAKER (for himself, Ms. ESHOO, Mr. DREIER, Mr. KENNEDY of Minnesota, Mr. HONDA, Mrs. TAUSCHER, Ms. LOFGREN, and Mr. CANTOR) introduced the following bill; which was referred to the Committee on Financial Services

JUNE , 2004

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union and ordered to be printed

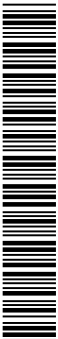
[Strike out all after the enacting clause and insert the part printed in italics]

[For text of introduced bill, see copy of bill as introduced on November 21, 2003]

A BILL

To require the mandatory expensing of stock options granted to executive officers, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*



1 **SECTION 1. SHORT TITLE.**

2 *This Act may be cited as the “Stock Option Accounting*
3 *Reform Act”.*

4 **SEC. 2. MANDATORY EXPENSING OF STOCK OPTIONS HELD**
5 **BY HIGHLY COMPENSATED OFFICERS.**

6 *Section 13 of the Securities Exchange Act of 1934 (15*
7 *U.S.C. 78m) is amended by adding at the end the following:*

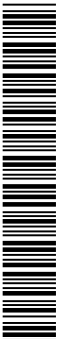
8 *“(m) MANDATORY EXPENSING OF STOCK OPTIONS.—*

9 *“(1) NAMED EXECUTIVE OFFICER.—As used in*
10 *this subsection, the term ‘named executive officer’*
11 *means—*

12 *“(A) all individuals serving as the chief ex-*
13 *ecutive officer of an issuer, or acting in a simi-*
14 *lar capacity, during the most recent fiscal year,*
15 *regardless of compensation level; and*

16 *“(B) the 4 most highly compensated execu-*
17 *tive officers, other than an individual identified*
18 *under subparagraph (A), that were serving as*
19 *executive officers of an issuer at the end of the*
20 *most recent fiscal year.*

21 *“(2) IN GENERAL.—Subject to paragraph (4),*
22 *every issuer of a security registered pursuant to sec-*
23 *tion 12 shall show as an expense in the annual report*
24 *of such issuer filed under subsection (a)(2), the fair*
25 *value of all options to purchase the stock of the issuer*



1 *granted after December 31, 2004, to a named execu-*
2 *tive officer of the issuer.*

3 “(3) *FAIR VALUE.*—

4 “(A) *IN GENERAL.*—*The fair value of an*
5 *option to purchase the stock of the issuer that is*
6 *subject to paragraph (2) shall—*

7 “(i) *be equal to the value that would be*
8 *agreed upon by a willing buyer and seller*
9 *of such option, who are not under any com-*
10 *pulsion to buy or sell such option; and*

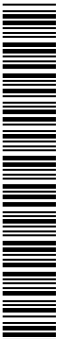
11 “(ii) *take into account all of the char-*
12 *acteristics and restrictions imposed upon*
13 *the option.*

14 “(B) *PRICING MODEL.*—*To the extent that*
15 *an option pricing model, such as the Black-*
16 *Scholes method or a binomial model, is used to*
17 *determine the fair value of an option, the as-*
18 *sumed volatility of the underlying stock shall be*
19 *zero.*

20 “(4) *EXEMPTIONS.*—

21 “(A) *SMALL BUSINESS ISSUERS.*—*This sub-*
22 *section shall not apply to an issuer, if—*

23 “(i) *the issuer has annual revenues of*
24 *less than \$25,000,000;*



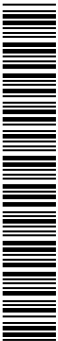
1 “(ii) the issuer is organized under the
2 laws of the United States, Canada, or Mex-
3 ico;

4 “(iii) the issuer is not an investment
5 company (as such term is defined under sec-
6 tion 3 of the Investment Company Act of
7 1940 (15 U.S.C. 80a-3));

8 “(iv) the aggregate value of the out-
9 standing voting and non-voting common eq-
10 uity securities of the issuer held by non-af-
11 filiated parties is less than \$25,000,000;
12 and

13 “(v) in the case of an issuer that meets
14 the criteria in clauses (i) through (iv) and
15 is a majority-owned subsidiary, the parent
16 of the issuer meets the requirements of this
17 paragraph.

18 “(B) *DELAYED EFFECTIVENESS.*—The re-
19 quirements of this subsection shall not apply to
20 an issuer before the end of the 3-year period be-
21 ginning on the date of the completion of the ini-
22 tial public offering of the securities of the issuer,
23 and shall only apply to an option to purchase
24 the stock of an issuer granted after such date.”.



1 **SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IM-**
2 **PACT STUDY.**

3 (a) *PROHIBITION.*—Section 19(b) of the Securities Act
4 of 1933 (15 U.S.C. 77s(b)) is amended by adding at the
5 end the following:

6 “(3) *PROHIBITION ON EXPENSING STANDARDS.*—

7 “(A) *IN GENERAL.*—The Commission shall
8 not recognize as ‘generally accepted’ any ac-
9 counting principle relating to the expensing of
10 stock options unless—

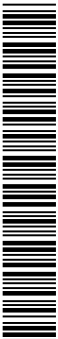
11 “(i) it complies with the requirements
12 of subparagraph (B); and

13 “(ii) the economic impact study re-
14 quired under section 3(b) of the Stock Op-
15 tion Accounting Reform Act has been com-
16 pleted.

17 “(B) *REQUIREMENTS.*—A standard referred
18 to in subparagraph (A) shall require that—

19 “(i) if an option to purchase the stock
20 of an issuer that is subject to the require-
21 ments of section 13(m) of the Securities Ex-
22 change Act of 1934 is exercised—

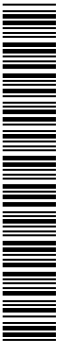
23 “(I) any expense that had been re-
24 ported under that section 13(m) with
25 respect to such option shall be recom-
26 puted as of the date of exercise and



1 *shall be equal to the difference between*
2 *the price of the underlying stock and*
3 *the exercise price; and*

4 “(II) to the extent the recomputed
5 amount differs from the amount pre-
6 viously reported under section 13(m)
7 with respect to such option, the dif-
8 ference shall be reported in the fiscal
9 year in which the option is exercised
10 as a reduction or increase, as the case
11 may be, of the total expense required to
12 be reported under that section 13(m)
13 during that fiscal year;

14 “(ii) if an option to purchase the stock
15 of an issuer that is subject to the require-
16 ments of section 13(m) of the Securities Ex-
17 change Act of 1934 is forfeited or expires
18 unexercised, any expense that had been re-
19 ported under that section 13(m) with re-
20 spect to such option shall be reported in the
21 fiscal year in which the option expires or is
22 forfeited as a reduction of the total expense
23 required to be reported under that section
24 13(m) during that fiscal year; and



1 “(iii) to the extent that any reduction
2 required under clause (i) or (ii) exceeds
3 total option expenses for any fiscal year,
4 such excess shall be reported as income with
5 respect to options to purchase the stock of
6 the issuer.”.

7 (b) *ECONOMIC IMPACT STUDY*.—Not later than 1 year
8 after the date of enactment of this Act, the Secretary of
9 Commerce and the Secretary of Labor shall conduct and
10 complete a joint study on the economic impact of the man-
11 datory expensing of all employee stock options, including
12 the impact upon—

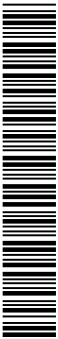
13 (1) the use of broad-based stock option plans in
14 expanding employee corporate ownership to workers
15 at a wide range of income levels, with particular
16 focus upon non-executive employees;

17 (2) the role of such plans in the recruitment and
18 retention of skilled workers;

19 (3) the role of such plans in stimulating research
20 and innovation;

21 (4) the effect of such plans in stimulating the
22 economic growth of the United States; and

23 (5) the role of such plans in strengthening the
24 international competitiveness of businesses organized
25 under the laws of the United States.



1 **SEC. 4. IMPROVED EMPLOYEE STOCK OPTION TRANS-**
2 **PARENCY AND REPORTING DISCLOSURES.**

3 (a) *ENHANCED DISCLOSURES REQUIRED.*—Not later
4 than 180 days after the date of enactment of this Act, the
5 Commission shall, by rule, require each issuer filing a peri-
6 odic report under section 13(a) or 15(d) of the Securities
7 Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)) to include
8 in such report more detailed information regarding stock
9 option plans, stock purchase plans, and other arrangements
10 involving an employee acquisition of an equity interest in
11 the company. Such information shall include—

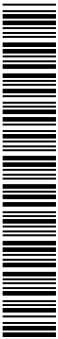
12 (1) a discussion, written in “plain English”, in
13 accordance with the Plain English Handbook pub-
14 lished by the Office of Investor Education and Assist-
15 ance of the Commission, of the dilutive effect of stock
16 option plans, including tables or graphic illustrations
17 of such dilutive effects;

18 (2) expanded disclosure of the dilutive effect of
19 employee stock options on the issuer’s earnings per
20 share;

21 (3) prominent placement and increased com-
22 parability and uniformity of all stock option related
23 information;

24 (4) the number of outstanding stock options;

25 (5) the weighted average exercise price of all out-
26 standing stock options; and



1 (6) *the estimated number of stock options out-*
2 *standing that will vest in each year.*

3 (b) *DEFINITIONS.—As used in this section:*

4 (1) *COMMISSION.—The term “Commission”*
5 *means the Securities and Exchange Commission.*

6 (2) *ISSUER.—The term “issuer” has the meaning*
7 *provided in section 2(a)(7) of the Sarbanes-Oxley Act*
8 *of 2002 (15 U.S.C. 7201(a)(7)).*

9 (3) *EQUITY INTEREST.—The term “equity inter-*
10 *est” includes common stock, preferred stock, stock ap-*
11 *preciation rights, phantom stock, and any other secu-*
12 *rity that replicates the investment characteristics of*
13 *such securities, and any right or option to acquire*
14 *any such security.*

15 **SEC. 5. PRESERVATION OF AUTHORITY.**

16 *Nothing in this Act shall be construed to limit the au-*
17 *thority over the setting of accounting principles by any ac-*
18 *counting standard setting body whose principles are recog-*
19 *nized by the Securities and Exchange Commission under*
20 *section 19(b)(1) of the Securities Act of 1933 (15 U.S.C.*
21 *77s(b)(1)).*

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